Commentary – January 1, 2014

2013 was a year to remember for those invested in the stock market. As of December 27^{th}, the S&P 500 Index, a broad-based gauge of large capitalization stock performance, was up 29%. Small cap stocks, as measured by the Russell 2000 Index, increased by over 36%. International stocks, valued using the Morgan Stanley European & Far East yardstick, rose by almost 19%. The only disappointing equity class was emerging market issues, down 8%. During the course of any year it is normal for equity investors to bear a period of negative returns; in 2013 this interim was brief, with a drop of only 6% lasting from late May until late June. The market quickly regained these losses and marched higher, occasionally pausing to catch its breath.

There will, of course, be those who proclaim this rise unsustainable. They will point to out-of-control government spending, structural problems with European banks, geo-political strife in the Middle East and domestic tax/regulatory policies which hobble business. Others will assert the market's substantial gains have been built on little but a strategy employed by the Federal Reserve Bank to increase the money supply and ease credit. Whether or not you agree with the quantitative easing approach, the Fed's massive bond buying has had a significant positive effect on the market, and those who follow the axiom "Don't Fight the Fed" have been amply rewarded. The tapering process signaling the end of the program could provoke market volatility, and investors should prepare for this possibility.

It would be reasonable to anticipate a softer year in the stock market in 2014. Statisticians and market-watchers will cite the concept of "reversion to the mean", wherein high and low prices are temporary and deviations expected to revert back to the average. We are now in the 4^{th} year of a bull market and while the ride has been tumultuous at times (see summer 2011) the major indices are at all- time highs. The 2013 return of the S&P 500 Index is the 5^{th} best since its creation in 1957. (Financial Times December 24^{th}, 2013) Since this amount is well above the historic average of 9%, one should not count on another year of 20% plus gains.

We do not, however, suggest converting a significant portion of one's stock holdings to cash. The four years in which the S&P 500 performed better than 2013 (1958, 1975, 1995 & 1997) were followed by an additional year of positive returns, ranging from 8.5% to 26.7%. (FT 12/24) Stocks valuations on a price-earnings basis are not at inflated levels. Employment rates are healthier, housing starts are rising and interest rates are low. Corporations are flush with cash, allowing for share buybacks and increased dividends, both beneficial to shareholders. Composite leading economic indicators in most major countries are showing signs of improvement. For investors with a long term time horizon, equities remain the best investment vehicle. Nevertheless, it is a propitious time to review the allocation of your portfolio and ensure it is aligned with its target mix of asset classes. If it is misaligned, and your risk tolerance has not changed, re-balancing by selling some stock positions may be warranted.

As always I invite you to contact me with your questions and concerns and am available to meet at your convenience.

May 2014 bring health, happiness and prosperity to all our valued clients. We greatly appreciate your business, and look forward to working with you again in 2014.